

South Africa Local Government Financial Reform Project

Final Report

10 September 2001

Task 4: Revenue Expenditure Assignment—Overview Report

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SA LOCAL GOVERNMENT FINANCIAL REFORM PROJECT:
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Prepared by Palmer Development Group



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REVENUE EXPENDITURE ASSIGNMENT—OVERVIEW REPORT

10 September 2001

1 INTRODUCTION

Task 4 of the local government reform project deals with revenue assignment. In order to do this effectively it is necessary to understand the costs faced by local government at both the local and district level and their patterns of expenditure. To do this, in turn, requires an understanding of the powers and functions to be allocated to each sphere of local government. These issues are dealt with in the full report on the arrangements for each municipal services sector, and are examined at a case study level in the three accompanying case studies.

This document is a summary of the key issues contained in the full sector report and case study summary. This summary first examines the main institutional issues that the new municipal demarcation gives rise to. The report then considers the financial issues of expenditure patterns and revenue options.

The analysis presented here arises from research at the national level into the management of the various types of local government services (the main Sectoral Report). This research is supported by case studies which reflect current expenditure realities at the local level. The report must be seen in the context of the overall local government reform project. It only provides one piece of the local government finance ‘puzzle’ and will be most valuable when used alongside the other project reports.

2 FACTORS AFFECTING THE VIABILITY OF MUNICIPALITIES

Local government is currently in the process of transition and the proposals from this task of the project are intended to be used for the post-transition municipalities. At present these municipalities have not had powers and functions assigned to them. Therefore, as part of this task, it is necessary to make certain assumptions in this regard, based on a set of principles. As the over-riding principle needs to be that of achieving long term viability of local government it is important to consider the factors which influence viability. Six key factors have been identified:

- a. Consumer profile (essentially the ratio between poorer and wealthier consumers)
- b. Strength of local economy.
- c. Settlement density.
- d. Capacity of the municipality (primarily management capacity).
- e. Existing service levels.
- f. Access to subsidies.

2.1 Management Capacity

In the short term it is only possible to influence the capacity of the municipality and access to subsidies. Therefore these factors are given primary attention in the full report.

The issue of management capacity is particularly important at this stage of the transition in local government arrangements as it is something which can be influenced in the re-

structuring process. Further, in allocating powers and functions the ability of the municipalities to manage the functions allocated to them is a central consideration. The key issue relating to management capacity is that this is presently located in the previous transitional local councils (TLCs) which are primarily responsible for urban areas. Further, capacity is concentrated in the larger TLCs. With regard to district municipalities these have focused their attention to date primarily on resource allocation, planning, and contracting capital works. Current district municipalities have little service provider capacity.

2.2 Service Backlogs

The driver behind municipal expenditure in the medium term will be the extension of municipal services infrastructure to unserved households. The rural areas pose the greatest challenge in this regard. The KwaZulu/Natal district level case study presents a typical example of service backlogs. In the urban areas over 50% of households have a full level of supply of water and sanitation, electricity and solid waste collection. In the rural areas of the district less than 18% of households have access to a full level of water, almost none (<1%) have waterborne sanitation, and less than 5% have access to a full level of electricity supply. More seriously, well over 50% (more than 80% in the case of electricity and solid waste) of households have no, or an inadequate, supply of the major municipal services.

2.3 Capital Expenditure

Major capital expenditure is therefore required to equalise access to services. Until the recent municipal demarcation there was somewhat of a disjuncture between capital expenditure and operational expenditure to cover the recurrent costs of service provision. To a significant degree District Councils were a major source of capital spending in rural areas, however, they had very limited service provider capacity and did not assume responsibility for operational costs or for the raising of revenue through user charges. This arrangement inhibited proper financial planning and appropriate evaluation of the operational cost implications of capital programmes.

The recent demarcation should begin to address this issue, with moves towards more clearly defined responsibilities for different services at the local and district level. Once the allocation of responsibilities has been established more comprehensive planning will be able to occur. A key issue in this regard is to ensure that financial flows, including the ability to recover costs from user charges and from targeted subsidies, are well matched with the allocation of functions.

3 INSTITUTIONAL AND ORGANISATIONAL ARRANGEMENTS

From the case study assessments and sectoral analysis the following areas are identified as key issues:

- a. Separate identity of functions of *service authority* (primarily governance, planning and regulatory aspects) and *service provision* (actual provision of the service).
- b. The importance of *settlement level responsibility*: a large component of service provider activity cannot be carried out remotely from consumers and needs to be based in settlements. As local authority structures are becoming geographically larger

this places a new demand on new municipalities. For settlement level responsibility to be exercised effectively two options have been identified: use of *community based organisations* as service providers or use of *area based management*.

- c. *Types of service provider*: a range of service providers can be appointed, including other spheres of government, para-statal organisations, community based organisations and private sector bodies.
- d. *Split responsibility*: A single service (water supply, for example) may be run by two services providers, one providing bulk services and one retail. Another form of split responsibility occurs where a locally based service provider is provided with support from one based at regional level. (Support can include treasury functions, project implementation, procurement, mentoring or major maintenance).
- e. *Internal organisational arrangements*: As municipalities get larger both in terms of staff numbers and geographic areas, they will need to pay greater attention to organisational structure. Possible models dealing with different degrees of centralisation and separation of specialist support are identified in the full report.

While the above organisational issues are in broad terms central to the efficient allocation of powers, functions and expenditure local conditions (and history) remain important. The case studies identified some important local differences that need to be considered in a consideration of appropriate institutional arrangements and in considering expenditure patterns of different municipalities:

- a. *Historical differences*: there are some distinct historical differences across provinces in service provision arrangements that affect local government. For example in Kwa-Zulu/Natal all ambulance services are provincially run and funded, whereas in the Eastern Cape the DC plays a role in the provision of this service. There are historical and other reasons for these different provider arrangements which will have commensurate impacts on expenditure patterns.
- b. *Pre-existing capacity*: The Mpumalamga rural category municipalities appear to have stronger TLCs with greater capacity than the Eastern Cape and Kwa-Zulu/Natal rural municipalities. The result of this is that a wider range of services tend to be provided in the Mpumalamga rural municipalities than in the other two case studies where rural municipalities carry out very minimal functions. This points to the important fact that there is a continuum of local municipality types with a wide range of capacity. The full range, however, cannot be captured in a few case studies.
- c. *Strength of local economy*: the economic base of the local municipality was not the focus of the study. However, it is obviously key in determining revenue issues and local capacity. There are significant differences in the economic base between case study areas, even within the same local municipality type. For example the Mpumalamga case study area has a rural economy that appears better off, possibly due to tourism and border activities, than the Eastern Cape and Kwa-Zulu/Natal rural areas.

3.1 Key Service Level Issues for Each Sector

The management of each municipal service are not only dependent on allocations of powers and functions for that service, there are also particular issues that arise in each sector. A summary of the key issues faced by each sector is given below:

- a. *Overheads*: This study has not dealt particularly with overheads. However, although it is not a 'sector' it has been found in the case studies to be a major driver of municipal costs, particularly in rural areas. It is clear that considerable work needs to be done to understand overheads and to look at ways of containing costs.
- b. *Water supply*: Water supply in urban areas is generally adequately managed, although there are significant backlogs. In rural areas there has been considerable progress with the implementation of projects over the last 6 years. However, service provider arrangements are still poor, meaning that rural schemes often fail. The role of community based organisations and private sector support need be given strong emphasis.
- c. *Sanitation*: In urban areas the trend has been to provide everyone with waterborne sanitation. However, this can not be sustained as it is not affordable to poorer communities, even less so if they live in low density settlements. In rural areas the funding and establishment of sanitation promotion programmes is of primary importance.
- d. *Electricity*: The major issues are in rural areas where coverage is still low, despite Eskom's success with its rural electrification programme. While much work has been done on 'off grid' options for scattered rural areas, households in these areas remain with poor access to energy.
- e. *Solid waste*: Better management of landfills and improvement of the 'softer' elements of the service (litter control) are important. In rural areas innovation with regard to informal arrangements needs attention.
- f. *Roads*: The declining quality of the roads network, particularly at levels 3 and 4 is extremely serious. This is the result of poor allocation of responsibilities and substantial under-funding.
- g. *Health services*: There is confusion relating the allocation of responsibilities for primary health care between province, district and local municipalities. The service is generally under-provided in rural areas and this is a growing concern due to the spread of Aids .
- h. *Emergency services (incl fire)*: These services are generally well suited to district scale management and new arrangements for improving coverage, particularly in rural areas, need attention. Province is taking increasing responsibility of emergency services.

- i. *Amenities*: Many urban local authorities are spending substantial proportions of their budgets on amenities, possibly as this is a high priority for councillors due to the visibility of amenities. In rural areas amenities are largely absent.

3.2 Principles to be Applied in Re-Structuring Local Authorities

In setting up new arrangements seven major principles aimed at promoting sustainable local government have been identified:

- a. Maximising access to services.
- b. Minimising cost.
- c. Management efficiency.
- d. Focus on customer service.
- e. Minimum disruption.
- f. Maximum accountability.
- g. Optimal cross-subsidy.

It is notable that these principles are often contradictory for a particular municipality and a balance needs to be reached. With regard to cross subsidies, it is suggested that, while cross subsidy at a local municipality level is appropriate, it should not be promoted at district level. A similar argument applies to institutional capacity. At present the bulk of municipal institutional capacity is located in the larger urban former TLC areas. While there are demands (such as those implied in the amendment to the Municipal Structures Act) for this capacity to be utilised across the district there are concerns that this may overburden the already stretched capacity of these areas, with undesired consequences.

It is suggested that those high capacity local authorities in a district municipality should be used to support other providers but should not be assumed to be the most appropriate authorities to take on service provider roles themselves. Decentralisation still seems to be a necessary component of a service provision strategy allied with strong support from the district level.

In this regard it is apparent that community based organisations (CBOs) have an important role to play in service provision, particularly at the level of small (<5 000 households) settlements. There is enough evidence in the water sector to demonstrate that these organisations are often the only viable service providers for the short and medium term. Solid waste management, on-site sanitation, local roads and possibly non-grid electricity can also be provided through CBOs in the post-demarcation context. Post demarcation local authorities, with stronger district municipalities, are likely to show a greater degree of centralisation. Service provision at the settlement level through CBOs offers a way of continuing to provide decentralised services, responsive to consumer needs.

3.3 Models for New Municipal Arrangements

The practical implementation of powers and functions involves the assigning of the following municipal responsibilities appropriately to local and district municipalities or to other services providers:

- Service authority, possibly separated for different services.

- Service provider, possibly separated into bulk and retail components.
- Support services.

A range of models are identified in the full report and each one is weighed up against the principles for different types of local municipality. In summary the following conclusions are drawn:

- a. In general, for a *local municipality with a large town as core*, the current arrangement where they retain full service authority and service provider functions is preferable, from their own perspective. The arguments for moving away from this relate primarily to the desire by districts and province to share the capacity of the existing TLCs over a wider area and cross-subsidise from large town cores over the whole district. Where there are some management efficiency arguments to run some services at a district level there is an argument to do this with the service provider (perhaps a district municipality) contracted to the local municipality which will be the authority. Similarly, while there are some equity arguments to cross subsidising across local municipalities in a district there are serious concerns that economically viable urban areas will be rendered unsustainable if they are required to support large rural hinterlands. If there is a funding gap at the local level there are strong economic arguments for national level cross subsidies.
- b. From the perspective of a *local municipality with a small to medium sized town as core*, the arrangements need to be considered internally and externally. Internally it is considered best for retail service provider capacity to be located at local (settlement) level, as far as possible. However, such service providers need to be backed up with a good support and bulk service function. Often this is best located at the district level as capacity can be shared across the district. In balance it may be best for the authority function to rest at district level.
- c. With regard to *local municipalities with no town as core (all rural)* the conclusions are similar to that for the previous case. For the internal arrangements, a strong preference is indicated for services provider activity to be delegated to settlement level as far as possible. However the extent to which this is done is strongly dependent on the type of service. With regard to higher level skills, these are typically absent at local municipal level currently. It then becomes more obvious that these should be shared across the district.

3.4 Organisational Arrangements for Particular Services

A summary of the proposals for each of the sectors investigated is given in the two tables on the following two pages below, with the codes used as follows:

Code	Description
B	Category B (local) municipality
B1	Category B municipality with a large town or small city as core.
B2	Category B municipality with a medium sized town as core.
B3	Category B municipality with a small town or group of small towns as core.
B4	Rural category B municipality with effectively no urban core.
C	Category C (district) municipality
L	Settlement level
a	<i>Service authority</i> : The 'core functions' of a local authority, including governance, regulation and planning.
p	<i>Service provider</i> : The organisation which actually provides the service and contracts with the consumer.
p1	<i>Retail service provider</i> : For many services the function can be split into bulk and retail services. Retail includes that part which requires the distribution of the service from a point of bulk supply (or bulk collection in the case of waste related services) to (or from) consumers.
p2	<i>Bulk service provider</i> : That part of the service which links the resource to the distribution (retail) service. This includes generation in the case of electricity, treatment in the case of water supply and wastewater and landfill in the case of solid waste services.
s	<i>Support</i> : Also part of service provider activity but can be contracted out. Support services are taken to include services required on a month-to-month basis associated with providing a service but outside the core activity of a service provider: treasury, human resources administration, information systems, mentoring of lower levels of management and operations staff, major maintenance, vehicle workshops, procurement etc.

Organisational Arrangements for the ‘Big 5’ Municipal Services

Service	Description	Favoured Model For:			Rationale
		B1	B2/3	B4	
Water supply	There are a variety of situations ranging from small local schemes, to large regional schemes. A feature of water supply arrangements is that there is often considerable settlement level activity.	Ba Bp	Ca Lp1 Cp2 Cs	Ca Lp1 Cp2 Cs	For a B1 municipality they have traditionally had the capacity to run their own systems, with or without bulk services. For B2 to B4 there is a strong argument for retaining as much service provider responsibility as possible a settlement level but backing this up with support at C level (or possible B level in the case of B2)
Sanitation	The sanitation service has different requirements for reticulated waterborne systems, on site sanitation and the ‘soft’ promotion elements.	Ba Bp	Ca Lp Cs	Ca Lp Cs	The rationale for the favoured models is similar to that for water supply. However, there is typically less argument for splitting the retail and bulk activities in B2 to B4 situations.
Electricity	In comparison to water supply, electricity is relatively easily managed as generation does not need to be considered and sales are more easily managed.	Ba Cp	Ca Cp	Ca Cp	Electricity models are strongly dependent on the findings of the current sector re-structuring initiative where REDs are being considered. However, it is likely that regional systems will be favoured, hence the Cp options given here. However, in B1 situations it is not certain that they will give up either or both of their authority and provider functions.
Solid Waste	The service can be considered separately from a collection and disposal (landfill) perspective. It also needs to be recognised that for smaller settlements informal arrangements will be required if the service is to be affordable.	Ba Bp1 Bp2	Ca Lp1 Cp2	Ca Lp	In all cases it is likely that collection (p1) activity should be located at settlement level. However, there may be circumstances where two places are close enough together to share vehicles. From the landfill point of view there are merits to both Bp2 and Cp2 options. However, district responsibility may have the edge. For rural settlements there is little argument to split service provider activity.
Roads	The roads system has a hierarchical nature and is suited to responsibilities matching the geographic hierarchy of government structures. In a local govt. context, ‘retail’ can be considered to be settlement level roads and ‘bulk’ district level roads.	Ba Bp1 Cp2	Ca Lp1 Cp2 Cs	Ca Lp1 Cp2 Cs	There are sound arguments for a strong district level roads authority and service provider to take responsibility for the district roads network. Local (settlement level) roads should have routine maintenance done locally. However, support from a district level unit will be important for major maintenance of settlement level roads in smaller settlements.

Organisational Arrangements for Other Municipal Services

Service	Description	Favoured Model :			Rationale
		B1	B2/B3	B4	
Traffic and transport	Most traffic control functions are local level activities such as traffic control and regulation, vehicle licensing, and taxi ranks. Very few local authorities provide effective public transport	Ca Bp Cp2	Ca Cp2 Bp1	Ca Bp1 Cp2	These services are divided into those services, such as traffic control and taxi ranks, for which all except the smallest towns could assume provider responsibility. The more complex functions, such as public transport and vehicle licensing, could benefit from economies of scale and district level provision.
Primary health care	This consists of the operation of primary health care clinics, as well as other non-clinic health services such as health education, AIDS awareness, and others.	Ca Cp2 Bp1	Ca Cp	Ca Cp	Health care is a complex service requiring technical and managerial oversight. It is likely that only the large towns will have the capacity to provide this service themselves. In the smaller towns and rural areas the district will be best placed to provide both the 'hard' and 'soft' health care services. Provincial and national government will also have an important support and funding role.
Emergency services	Fire and emergency response is the main function, as well as ambulance services in some cases. Fire prevention is also an important area as is disaster management.	Ca Cp	Ca Cp	Ca Cp	These services are best provided at a district scale. There are large economies of scale and the services do not generally require settlement level or local management to a large degree. There are successful examples of private sector providers being contracted at a local and district level.
Community services (1)	For management purposes community services can be divided into those that can be provided regionally and those which can be provided locally. Regional services include libraries, cemeteries, museums, and regional sports facilities.	Ca Cp	Ca Cp	Ca Cp	By definition there are community services that can service a wide area or that can best be centrally provided. Although the large urban areas could provide these services, because of their regional character it is probably preferable to centralise the authority and provision of these services.
Community services (2)	Local community services include parks and local sportsfields, creches, and community halls.	Ba Bp	Ba Lp	Ba Lp	By definition these services are able to be provided and managed at the local municipality or even the settlement level. These services are meant to support community cohesion and local level needs and should be provided at the most local level possible.
Local economic development	Local government is meant to have a developmental focus including the development of the local economy. Possible activities include tourism promotion, small business centres, etc.	Ca Bp1 Cp2	Ca Bp1 Cp2	Ca Cp	The district should assume high level & district-wide LED functions & planning support. In municipalities with the capacity the actions required may be able to be provided locally, but rural municipalities will typically have inadequate capacity.

4 EXPENDITURE AND OPERATING COSTS

The case studies at the district and local municipality level were undertaken to analyse patterns of local government expenditure and to provide some ideas of the unit costs of providing municipal services. The case study cost data was used to add to pre-existing information on the costs of municipal service provision.

The case studies looked at three District Councils: DC12 (in the Eastern Cape), DC32 (in Mpumalanga), and DC22 (in Kwa-Zulu/Natal). In each DC local municipalities representing three types were chosen – one with a large urban core, one with a small, or a number of small urban centres, and a rural local municipality with a very small or absent urban core. These three types are referred to as *large urban*, *small urban*, and *rural*.

An important driver of the costs of service delivery is the settlement type of the area, with less dense rural areas having significantly greater costs of services per household than urban areas. To refine the assessment of projected local government expenditure requirements the case study districts were divided into five settlement types: urban, dense settlements, villages, scattered settlements, and farmland. This assignment by settlement type also allowed for census data to be extracted according to the new municipal boundaries.

The case studies were selected so as to include some former ‘homeland’ areas. These areas were not analysed according to their historical boundaries, but rather as explained above, according to the settlement type (and hence cost driver) of the area. Most of the former ‘homeland’ areas included fell into the villages and scattered settlement types.

The required expenditure incurred by a particular local municipality may change in the future if the allocation of functions to that municipality changes. However, the actual expenditure requirements (made up of the capital expenditure to address backlogs in infrastructure and to maintain current infrastructure, and the operating costs of the area) will not change substantially. There may be some cost reductions, due for example to economies of scale if a service can be provided more efficiently at a district-wide level, or due to a reduction on overheads from a consolidation of management structures. At the level of assessment carried out in this study, however, it was not possible to provide estimates of these cost changes.

4.1 Other Service Providers

A limitation is that the information presented only refers to services provided by district or local municipalities. There are a number of other provincial, national and parastatal organisations that provide services directly to communities. The current expenditure on these services is not quantified in the case studies although future expenditure on some services provided by outside agencies (such as electricity) is looked at when assessing the funding gap.

The future contribution of these external agencies will therefore be an important issue when assessing future local government revenue needs. These agencies include various provincial government departments (e.g. Public Works, Local Government and Housing, Land Affairs), national government departments (Department of Water Affairs), Water Boards, Eskom, Telkom, community based organisations (e.g. village water committees), NGOs, and the private sector.

4.2 Expenditure Categories

Local governments spend their funds on a very wide range of functions, ranging from dog pounds, to local radio stations, to bulk water supply. To provide a useful picture of expenditure patterns some form of classification of this expenditure was needed. To this end expenditure was divided into nine categories. The categories used also relate to the sectors being looked at in the sectoral report. The categories and a brief explanation of them is shown below:

- a. *Overheads*: This includes all the council expenses and other ‘costs of democracy’ as well as the typical overheads found in local government classifications such as the town treasurer, town clerk, administration services and similar. This is the probably the most difficult area to categorise correctly and is discussed further below.
- b. *Economic & trading services*: This includes the main trading services of water and electricity, as well as those other services for which user charges are or can be levied such as sanitation and refuse removal. Other economic services include commonage charged for and commercial property. All the services classified under this heading in the financial statements were included in this category.
- c. *Roads, transport & traffic*: This includes actual road construction and maintenance and traffic management, as well as public transport and related services such as licensing.
- d. *Health & emergency services*: The main services here are fire and emergency services, clinics and primary health care and environmental health and hygiene expenditure.
- e. *Amenities & works*: This category includes a wide range of public amenities such as libraries, creches, sports fields, recreational areas, museums and other cultural matters. Also included are cemeteries and community halls. Public works is also included which tends to represent general otherwise unclassified infrastructure expenditure and small projects.
- f. *Protection services*: This includes security and protection services and any municipal policing functions carried out.
- g. *Planning & regulation*: A range of planning functions are included here such as integrated development plans, as well as town planning and planning permissions. Regulation includes direct regulatory functions not included elsewhere such as inspection of facilities.
- h. *Housing*: Some local authorities have housing estates or similar, this forms the bulk of this category. Any other housing support, although this is normally not on the local authority budget, is also included.
- i. *Local Economic Development*: Some local authorities classify certain activities as LED. In addition an assessment was made of other activities that would be construed as LED such as tourism promotion or the establishment of hawker facilities.

A difficulty with analysing local authority financial statements in South Africa is how to deal with the overheads item. It is likely that in many TLCs, especially the small rural ones, a number of items are included in overheads that should be apportioned to other services. For example staff costs may all be categorised as overheads when in fact some staff time is devoted to service delivery. An attempt was made to apportion the overheads to the various functional areas of the TLCs and all obviously non-overhead line items were categorised with their respective function. However a large non-classifiable overhead item still remained in many areas, particularly in the rural local municipalities.

An assessment was made that in the rural local authorities in fact much of these overheads actually do represent local government expenses that cannot be apportioned to other services. Many small TLCs have staff that manage very few services and in fact the ratio of overheads to other expenditure is very high. This is reflected in the individual case studies and discussed further there.

4.3 Operating Costs

Based on the case study and sector analysis a summary of operating costs, separated for urban and rural conditions and with a range of service levels, is given in the following table. They represent idealised budgets for different circumstances.

It should be noted that some of the figures in this table are based on the judgement of the consulting team, using case study results and other secondary data as the basis. The figures are also based on the provision of residential services only. They are for operating costs and do not include debt servicing. In the case of the basic services this debt servicing will not change the situation much as the capital cost of this service is largely grant funded. However, as the service level increases the provision for debt servicing needs to increase.

Indicative Operating Costs of Municipal Services for Urban and Rural Areas

Service	Average Cost (Rands per Household per Month)											
	Service Level - B1 (Urban) Type						Service Level - B4 (Rural) Type					
	Low		Moderate		High		Low		Moderate		High	
	R/m	%	R/m	%	R/m	%	R/m	%	R/m	%	R/m	%
Overheads	30	20%	40	13%	60	11%	50	36%	100	25%	150	21%
Water Supply	12	8%	27	9%	65	11%	15	11%	30	8%	50	7%
Sanitation	4	3%	35	11%	50	9%	6	4%	45	11%	80	11%
Electricity	25	17%	62	20%	150	26%	15	11%	88	22%	180	26%
Solid waste (incl streets)	15	10%	25	8%	35	6%	2	1%	15	4%	45	6%
Roads and stormwater	17	11%	20	6%	30	5%	20	14%	20	5%	20	3%
Health	15	10%	35	11%	75	13%	15	11%	35	9%	75	11%
Emergency services (incl fire)	5	3%	7	2%	10	2%	5	4%	15	4%	25	4%
Amenities	20	14%	55	18%	85	15%	10	7%	45	11%	70	10%
Other services	5	3%	8	3%	10	2%	2	1%	5	1%	8	1%
Total	148	100%	314	100%	570	100%	140	100%	398	100%	703	100%
Per capita figure (5 per hh)	30		63		114		28		80		141	
Per capita per annum (x12)	355		754		1368		336		955		1687	

Note: the assumption for these costs is that the municipality is the service provider for all services

Capital costs are dealt with under each section in the full report.

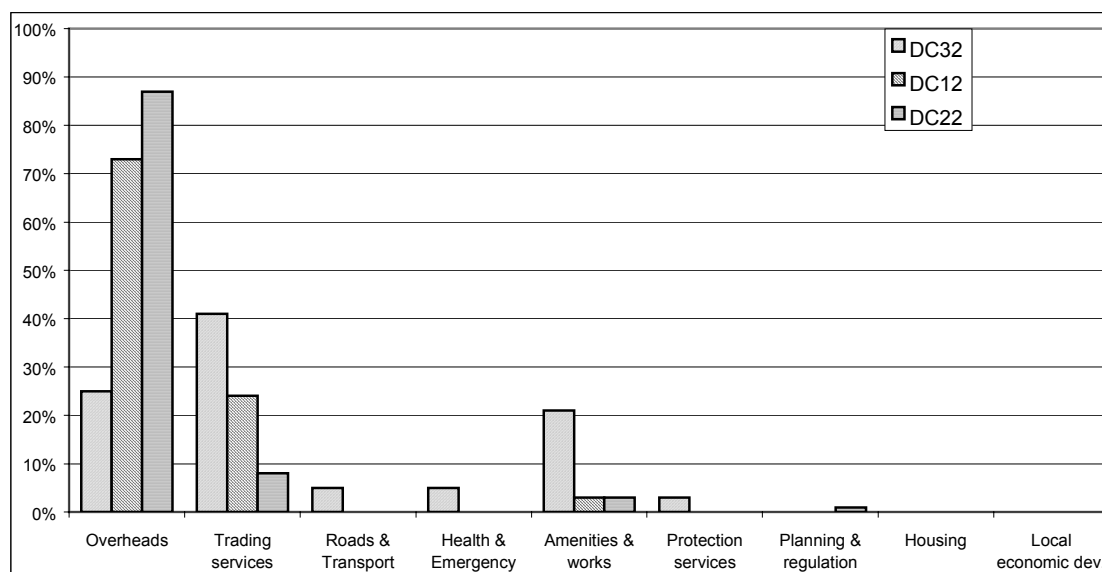
4.4 Case Study Comparison of Municipal Expenditure Patterns

The case study comparison of municipal expenditure is intended to support the revenue assignment component of the broader study by giving an indication of real spending patterns at the local level. An important output of the broader study is the alignment of revenue and expenditure at the local level and the analysis presented below addresses the expenditure aspect of this equation.

The similarities in expenditure patterns between the case study areas are quite striking. While there are regional differences as indicated above there are also fairly clear patterns emerging. These are best shown by means of the graphs below comparing the operating expenditure patterns across each case study for the same local municipality type.

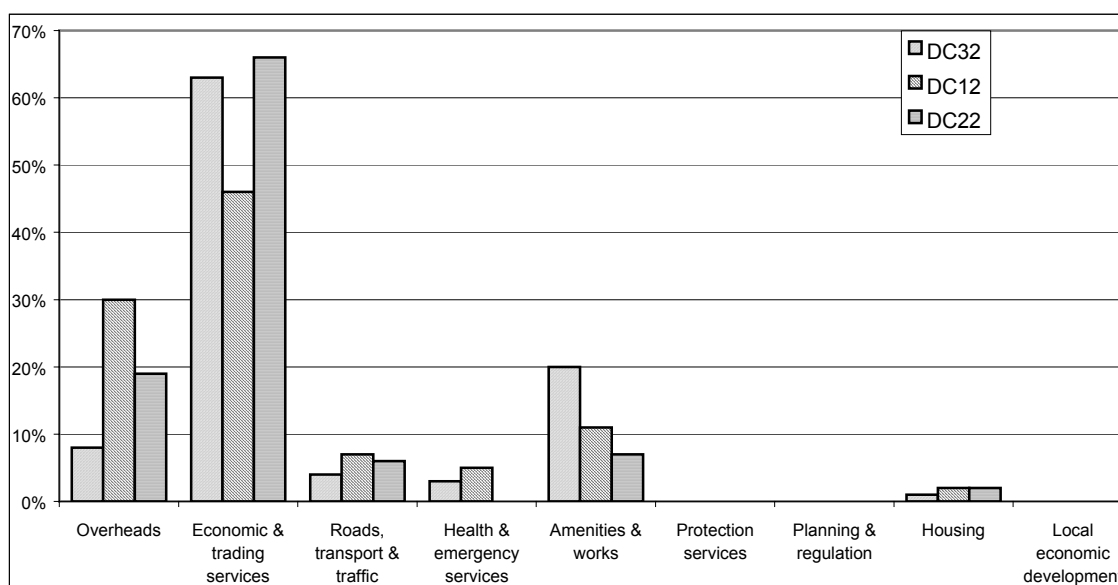
The expenditure of the rural local municipalities is dominated by overheads in DC12 and DC22, with DC32 having a more balance spread of spending. This is largely due to the stronger managerial and financial position of the rural TLCs in the Mpumalamga case study. Apart from overheads the second major expense is economic and trading services, with only DC32 indicating any expenditure of note on any other local government function.

Expenditure Patterns of Rural Local Municipalities



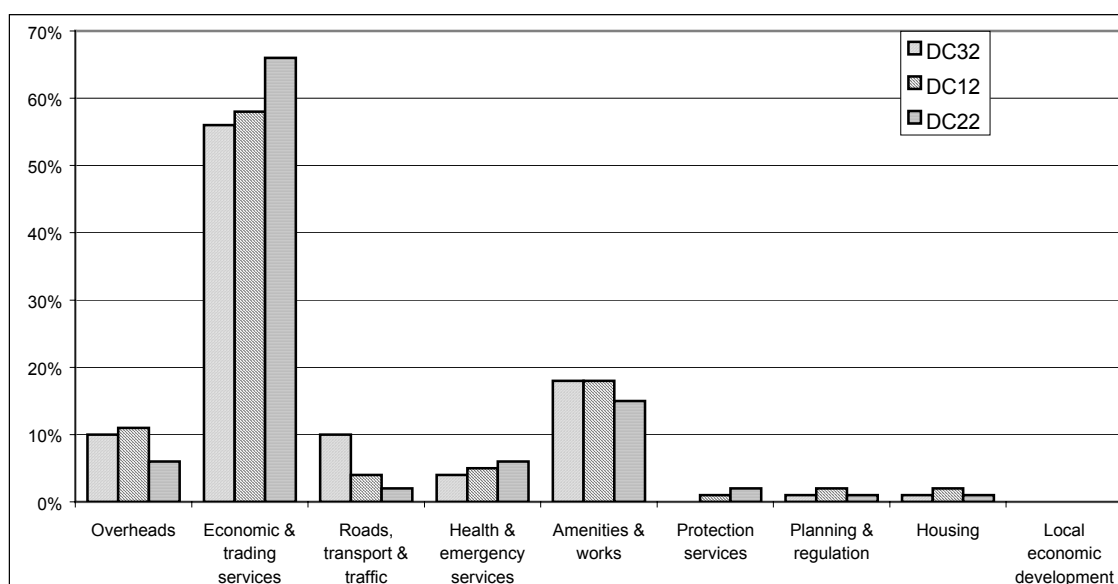
The small urban local municipalities have a more similar expenditure pattern across the case studies. Overheads begin to approach a more reasonable level but are still between 20-30% in DC12 and DC22, and there is a very strong emphasis on economic and trading services. Expenditure on a broader range of municipal services begins to become apparent.

Expenditure Patterns of Small Urban Municipalities



When one compares the large urban municipalities a very similar pattern emerges. Overheads are all under 10% of total operating expenditure, a similar large proportion of about 60% is spent on economic and trading services. A wide spread of spending on other municipal functions is seen.

Expenditure Patterns of Large Urban Municipalities



4.5 Issues Arising from Case Study Expenditure Analysis

The three case studies give an indication of current local government spending patterns and issues arising from this with respect to the future local government structures and their revenue requirements. The case studies do not form representative samples, nor are they

comprehensive in the analysis of all expenditure flows at the local level. They focus on local government expenditure to the exclusion of other service providers. With these limitations borne in mind some general points can be made.

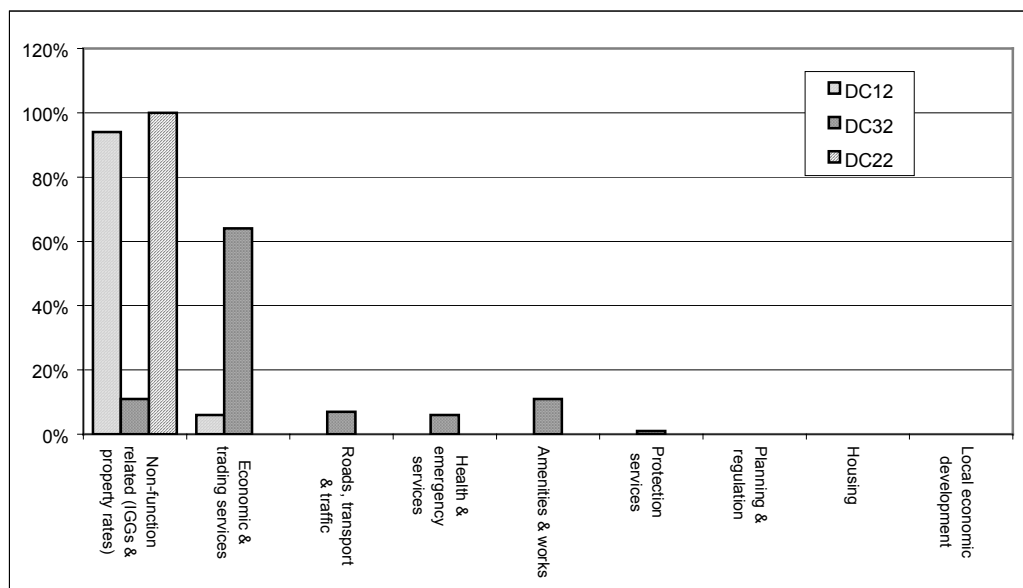
- *Low levels of operating expenditure in rural local authorities:* The rural local municipalities, largely due to their lower service levels and large relative service backlogs, spend the lowest amount per capita on service delivery functions. The per capita operating expenditure is much lower in the rural areas than in the urban areas (dramatically so in DC32), with the per capita expenditure on basic service delivery being even lower once overheads are accounted for.
- *Under-spending on infrastructure in rural areas:* The picture is similar with regards to capital expenditure. In DC22 and DC12 there appears to be relatively low capital expenditure in rural areas – despite the existence of District Councils, with district-wide capital spending mandates. These case studies show a disproportionately small amount of capital expenditure in rural areas when in fact the district resource redistribution function of the DC's should ensure a relatively higher expenditure in these areas. This problem is less evident in DC32. It must be noted that some of this spending gap is being filled by non-local government service providers, such as Eskom and the Community Water and Sanitation Supply programme of DWAF.
- *Greatest expenditure gap in rural areas:* The analysis of future expenditure requirements shows that as one moves from rural to small urban to large urban there is a growing disparity in favour of large urban between current expenditure and required expenditure on the main engineering services. The DC is likely to have to play a substantial role in these areas.
- *High overheads in rural local authorities:* There appear to be excessively high overheads at the rural municipality level, especially in DC22 and DC12. As discussed some of this may be an artifact of accounting practices but much of it is likely to demonstrate an inefficient use of resources. Whether the new municipal structures will be able to create economies of scale and improve the delivery to overheads ratio will be an important factor affecting their success.

5 KEY ISSUES RELATING TO REVENUE

The revenue of the case study areas was apportioned according to the same categories as that of expenditure. The following graphs show a cross study comparison of revenue sources according to the three municipal types used: rural, small urban and large urban. The item 'non-function related' includes both property and general rates and intergovernmental grants. It was generally not possible to distinguish between the two income streams from the local authority financial statements, however in the case of rural local authorities the vast majority (generally all) of this category is intergovernmental grants. In the case of large urban areas the vast majority of this category is property rates.

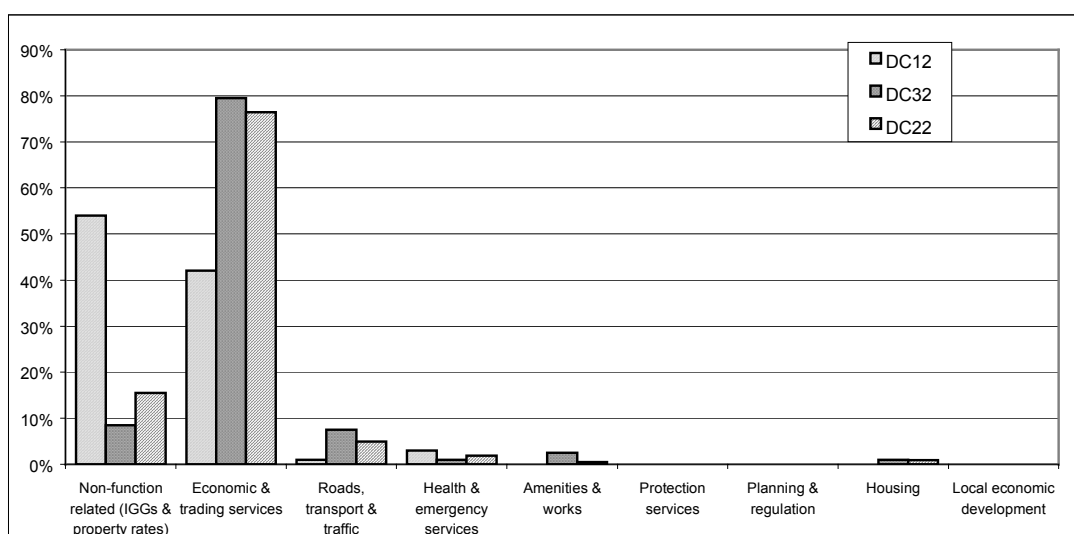
In the KwaZulu/Natal and Eastern Cape studies the bulk of income of rural authorities was from intergovernmental grants, made up of the equitable share and District Council grants. In the Mpumalanga case the rural authorities run some trading services and have a corresponding income stream from these services – making IGGs relatively unimportant.

Rural Income Profile



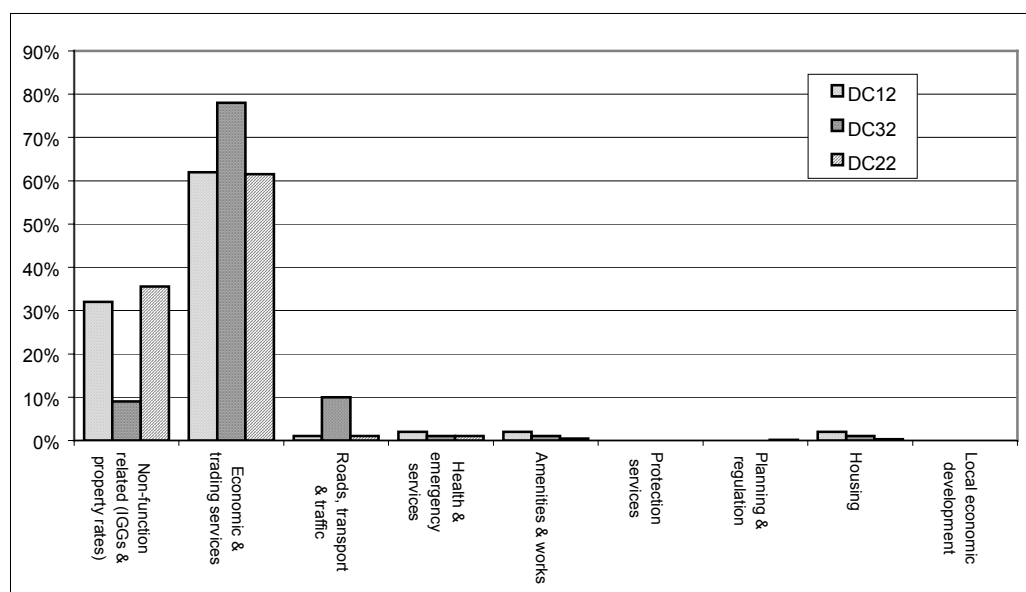
The situation changes dramatically as soon as a local authority becomes a service provider and has the associated authority to recover costs from user charges. The small urban areas (former TLCs) all provide trading services and revenue from user charges becomes their major income source. Only in DC12, the Eastern Cape case study area, were the combination of property rates and intergovernmental grants more important than revenue from trading services. In this area the equitable share made up 21% of income, with the remainder of 'non-function related' income coming from property rates. In the other case study areas a smaller proportion of the small urban municipalities' income was from the equitable share (3% in DC32 and 11% in DC22).

Small Urban Income Profile



Income in the large urban areas is dominated by revenue from user charges for trading services. A substantial proportion of user charges are from electricity supply. General ‘overheads’ income is primarily from property rates.

Large Urban Income Profile



Key issues related to revenue are summarised in the following table:

Overheads	Currently funded from rates income, equitable share and trading services surpluses. The current use of large proportions of equitable share funding to cover overheads, particularly in rural areas, is a major concern.
Water supply	Service in urban areas is generally funded from tariffs. In rural areas DWAF funds a large proportion of operating costs of large schemes. What little funding is raised for local retail activity is raised by communities themselves. The current political initiative to provide ‘free water up to 6kl a month’ is a concern from a sustainability point of view.
Sanitation	In urban areas funded through a mix of rates and tariffs. In rural areas largely un-funded.
Electricity	Costs covered by a mix of tariffs and national scale sectoral cross subsidies. With the restructuring of the sector the cross subsidy options is being reviewed, possibly to be replaced by a grant per household.
Solid waste	In urban areas either run as a trading service with tariffs or funded from rates account. Largely unfunded in rural areas.
Roads	In urban areas funded from rates account. In rural areas there is a serious lack of funding. Not only does the level of funding need attention but the mechanism needs review. At the moment funds flow through the province for rural roads but the province plays little direct role in providing roads.
Health services	This service is funded through a mix of provincial equitable share and local government rates account (75/25 split in Western Cape). In rural areas the province is typically sole funder. Funding levels and mechanism needs review.
Emergency services (incl fire)	Funded by province (medically related emergency service), RSC levies and municipal rates account. Needs attention.
Amenities	Certain amenities (libraries and museums for example) partially funded by province. Balance funded largely through rates account.

An important issue with respect to the revenue from user charges is whether particular trading services are on or off the local authority's budget. This is particularly important in the case of electricity which provides a substantial source of revenue for many municipalities. In the areas where Eskom is the service provider the revenue accrues to them and removes the possibility of cross subsidisation from the electricity trading account of the municipalities to other areas of municipal spending.

A second issue is the intergovernmental transfer of subsidies and the alignment of this with service provider responsibilities. For some services (such as health, roads, and rural water schemes) intergovernmental grants are the main source of revenue for the service. However there are certain misalignments between responsibilities and access to grants. For example, primary health care is a municipal function but the national grant for health care is provided to the provincial level. The provinces do not necessarily pass the grant down to those municipalities in proportion to the costs they bear in providing health services. A similar situation was found with roads.

Capital funding issues are not dealt with here as this has not been part of the brief. However, the need for innovative new grant mechanisms needs to be stressed.

6 CONCLUSION

This overview report has brought together the main findings and recommendations of the sectoral report and case studies. With respect to the main objective of the brief an expenditure analysis of local government has been provided, as well as typical costs of service provision. Issues related to the revenue raising potential of each municipal service have also been outlined, as has a case study assessment of sources of revenue for different types of local authority.

The insights gained into local government functioning have been used to make recommendations with respect to a set of principles for future allocation of powers and functions in the newly re-demarcated municipalities. A generic 'model' for assigning powers and functions has also been put forward.